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World commodity trends and prospects

Note by the Secretary-General

The Secretary-General has the honour to transmit to the General Assembly, as requested by it in its resolution 59/224 of 22 December 2004, the report on world commodity trends and prospects, which was prepared by the secretariat of the United Nations Conference on Trade and Development.

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World commodity trends and prospects

Report prepared by the secretariat of the United Nations Conference on Trade and Development

Summary

Since 2003, international commodity prices have recovered considerably. Although the factors behind the price increases differ somewhat among commodities, common factors include the economic boom in China, good economic perspectives in India and the United States and an economic recovery in Japan and Europe, as well as speculative inflows of funds into metals and energy markets.

Since most developing countries depend on commodity exports, the rise in commodity prices has, on average, been a positive factor for economic growth in those countries. However, the impact, measured by the change in countries' terms of trade and the portion of the increased revenues retained in the economy, has varied widely depending on the commodity composition of trade.

South-South trade is a particularly dynamic element of world commodity trade, owing particularly to the higher rate of growth in developing countries where per capita consumption of commodities increases fast. This new dynamism should be put to good use in supporting development and poverty reduction.

The suspension of the Doha round negotiations means that hoped for improvements in the functioning of world markets for agricultural products and supportive measures for developing countries, including through the aid for trade mechanism, are unlikely to materialize in the short term. Accordingly, the development of the commodity sectors will rely fundamentally on commodity specific policies at the international level, regional and national levels. The aid for trade mechanism should be pursued independently of developments in the Doha round of World Trade Organization negotiations and not be considered solely as a means to help countries adjust to trade liberalization. It should support the improvement of trading capacity and, taking into account the needs of the least developed countries and other vulnerable economies, should have a strong commodity focus.

The intergovernmental organizations identified in General Assembly resolution 59/224 have all continued to give priority to commodity issues in their work programmes. However, few new resources have been made available. In the present situation, technical assistance to support policy development and capacity-building assumes increased importance, particularly in order to enable developing countries to adjust to the requirements of expanding South-South trade.

The International Task Force on Commodities launched at the eleventh session of the United Nations Conference on Trade and Development (UNCTAD XI) has, regrettably, not entered into force, owing to the absence of financial support from Member States. The multitude of addressees of resolution 59/224, comprising private, public, national and international entities, is a clear demonstration of the need for appropriate mechanisms that allow consultation among stakeholders and focus the attention of Governments, civil society and the enterprise sector.

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I. Introduction

1. The present report has been prepared in response to paragraph 22 of General Assembly resolution 59/224, in which the Secretary-General of the United Nations was requested, in collaboration with the secretariat of the United Nations Conference on Trade and Development (UNCTAD), to report to the General Assembly at its sixty-first session on the implementation of that resolution and on world commodity trends and prospects.

2. The report is divided into four substantive sections. Section II provides a brief overview of developments in commodity markets over the past few years, with an emphasis on the factors underlying the recent commodity price boom (which had just started when resolution 59/224 was adopted) and its effects on commodity exporting developing countries. Section III focuses on one of the main factors behind the commodity price increases, which is also one of the most important features of the emerging pattern of world trade; that is, the increasing importance of South-South trade in commodities. Section IV reviews, as requested by the General Assembly, the implementation of resolution 59/224, and section V presents conclusions.

II. Commodity market developments

A. Price developments

3. International commodity prices recorded a sharp fall from mid-1997 to mid-2003. During this period, the UNCTAD commodity price index (including fuels) in current United States dollar terms lost about a third of its value. Since then, prices have recovered and the index reached a value of 187 in June 2006, considerably higher than its average 2003 level of 105 (see figure 1 below). Although the price increases for minerals and metals have been far larger than for other commodities, the recent rise is broadly based and can be considered as almost global except for the vegetable oilseeds and oils group, the price index of which decreased by 9.5 per cent between 2004 and 2005. Although the factors behind the price increases differ somewhat among commodities, common factors include the economic boom in China (where annual economic growth rates from 2002 to 2005 were close to 10 per cent and are expected to remain unchanged in 2006), good economic perspectives in India and the United States and an economic recovery in Japan and Europe.

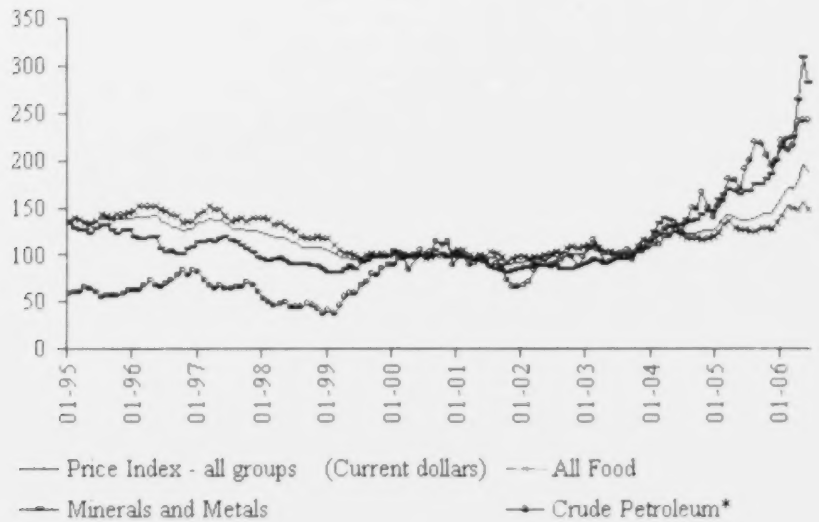
4. The price index for minerals and metals almost doubled between 2002 and 2005, mainly because of rapidly expanding Chinese demand (for instance, Chinese iron ore imports increased by 85 per cent between 2003 and 2005, accounting for almost 40 per cent of world imports in the latter year). A prolonged period of low prices, coupled with the long lead times in mining investment, led to slow capacity growth for many years and meant that supply could not catch up with the sudden increase in demand. Consequently, inventories of metals have been drawn down and are now in some cases at extremely low levels. The tightness of the market situation has enhanced the attractiveness of metals markets to investors dissatisfied with the prospects for returns on financial assets (see discussion in the following). During the 2002-2005 period, copper, nickel and zinc prices increased by respectively 136 per cent, 118 per cent and 74 per cent. This trend continued in the first half of

2006 with zinc and copper prices rising by 70 per cent on their 2005 level and nickel by 45 per cent.

5. Oil prices increased by 114 per cent between 2002 and 2005. The price rise continued in 2006 to reach $78 per barrel in July. As in the case of metals, Chinese demand growth (Chinese imports in 2005 were about two and a half times those in 2003) and speculation were significant factors. Worries about potential disruptions to supply, arising from events in several producing countries, including Bolivia, the Islamic Republic of Iran, Iraq, Nigeria and the Bolivarian Republic of Venezuela, also played a role and reinforced speculative sentiments.

Figure 1

Price indices in current United States dollars of major commodity groups, January 1995-June 2006 (2000=100)



Source: UNCTAD Commodity Price Statistics.

6. As a group, soft commodity prices recorded a significant rise over the 2002-2005 period, with those of food increasing by more than 24 per cent, tropical beverage prices by almost 42 per cent and prices of agricultural raw materials by 41 per cent. In some cases, for instance, natural fibres, natural rubber and sugar, the price increases partly resulted from substitution effects engendered by the jump in international oil prices. Rising hydrocarbon prices made some synthetic materials less competitive, which strengthened the position of natural materials such as cotton and rubber, resulting in an increase in both demand and prices. In the case of sugar, higher oil prices have led to increased demand for ethanol made from sugar cane and consequently to higher international sugar prices. The price of sugar could very well continue increasing in 2006 in view of the expected tightness of the sugar market. Brazil may experience a growth of the flex-fuel vehicle (vehicles that can use any combination of ethanol and petrol in different proportions) fleet to more

than 3 million vehicles by the end of 2006, compared to 1.5 million at the beginning of 2006, and other countries are also expecting considerable increases in ethanol demand.

7. Some other commodities have also recorded large improvements in prices as previous situations of oversupply have eased. Thus, coffee prices increased by 87 per cent from their low point during 2002 to 2005, with prices of some varieties increasing more than others. Still, coffee prices did not recover to their pre-1997, pre-crisis levels. Prices of coffees of Brazilian origin in 2005 remained 40 per cent below those of 1997.

8. Metals and energy markets have lately been exposed particularly to speculative influences that have contributed to raising prices to very high levels. Investors seeking both a low correlation with price movements for traditional asset classes and above-average returns,[1] have rerouted massive financial flows to (comparatively) thin commodity markets. Speculators seem to have used indirect strategies to avoid the risks of investments in physical commodity markets. Accordingly, investors, particularly hedge funds, have placed a large amount of money in commodity-based indices, which share many of the characteristics of traditional financial assets. About 200 billion euros are currently invested in commodities worldwide, half of them in commodity indices,[2] and hedge funds' investments in energy markets rose from $3 billion in 2000 to $90 billion in 2005.[3] The driving forces behind these placements are related less to fundamentals of commodity supply and demand per se than to macroeconomic and financial factors. The increased appetite for commodity-based financial instruments has been mainly fuelled by low interest rates and relatively robust economic growth worldwide. Furthermore, there has been a strong perception among speculators, supported by some analytical studies, that movements in the prices of financial instruments linked to commodity prices are negatively correlated with those of other financial assets, particularly equities of firms not active in commodities. Investing in commodities thus allows investors both to hedge portfolios against risks and to increase their global performance, especially when economic growth is fast and commodity prices rise owing to strong demand. According to some informal estimates, about 50 per cent of the increase in metal prices recorded during the first quarter of 2006 could be attributed to speculation.

B. Impact on developing countries

9. Since most developing countries depend on commodity exports, the rise in commodity prices has, on average, been a positive factor for economic growth in those countries and provides resources that can potentially be used for development purposes. However, the impact, measured by the change in countries' barter terms of trade, has varied widely depending on the commodity composition of their exports and imports. The countries that have recorded the largest improvement of their

[1] In 2005 returns on commodity indices and commodity-related stocks were 48.1 per cent and over the 2003-2005 period were 103.8 per cent.

[2] "Matieres premieres, pourquoi les marchés perdent leurs repères", Le Monde, Dossier economie, 13 June 2006; "La correction sur les métaux suscite des questions sur sa profondeur", Les Echos, 13 June 2006.

[3] "Oil that glisters", *The Economist*, London, 22 July 2006.

terms of trade are those exporting oil or mining products, which experienced improvements in terms of trade equivalent to respectively 6.7 per cent and 3.2 per cent of their gross domestic product (GDP).[4] On the other hand, terms of trade have deteriorated for countries that export mainly manufactured goods and import raw materials, particularly if they are energy importers. The change in terms of trade for countries exporting agricultural commodities products varies, depending on their level of oil imports, as well as on price developments for their main export commodities. Least developed countries are particularly dependent on commodity exports and the impact on their economies is correspondingly large. However, as for other developing countries, the direction of change depends on which commodities figure most prominently in their exports and imports. For example, oil exporters such as Angola and Equatorial Guinea have experienced very strong growth, whereas agricultural exporters with large oil import bills have encountered significant balance of payment problems.

10. The change in terms of trade does not, however, tell the full story of the impact of high prices on the economies of commodity dependent countries. One important factor is the extent to which higher commodity export revenues are retained in the economy of the exporting country. As noted by some observers,[5] a large share of revenues from the export of natural resource products such as oil or minerals may accrue to the enterprises exploiting those resources, rather than to host Governments or other actors in the national economy. In the latest mineral price boom, an additional factor reinforcing this tendency was that many mineral taxation regimes introduced in the 1990s made use of various mechanisms that had the effect of postponing the incidence of taxes until such time as the original investment had been recovered. Since metals prices have been low for several years, many mining companies have been able to offset large profits and only after these possibilities are exhausted do they start paying higher taxes. Another, more technical, reason is that profits that are reinvested may be registered in national accounts first as an outflow under the current account and then as an inflow under the capital account, without a connection necessarily being made between the two flows. This would tend to reinforce the impression of the additional income not benefiting the host country. Finally, for those countries that have indeed retained most or a large part of the extra income in their economies, the additional inflow of foreign currency may result in "Dutch disease" symptoms, that is, an appreciation of real exchange rates (manifested either as higher nominal exchange rates or, where exchange rates are fixed, as higher domestic inflation), which may damage the competitiveness of other sectors in the economy.

III. South-South trade in commodities

A. Recent evolution of South-South trade in commodities

11. Trade among developing countries has increased rapidly over the past several years, to the extent that the term "a new geography of trade"[6] has been coined to characterize it. The share of South-South exports in total developing country exports

[4] Figures from the Trade and Development Report 2006 (forthcoming).

[5] UNCTAD TDR/2005.

[6] See UNCTAD, TD/404.

roughly doubled over the past 30 years, increasing from about 23 per cent in the 1970s to over 40 per cent in the period 2000-2003, while the share of South-South imports rose from 26 to 44 per cent.[7] The rate of increase accelerated in the 1990s and in the first years of the new millennium. Trade in commodities is a particularly dynamic element in South-South trade, particularly when compared to developing countries' trade with developed countries. Although developed countries still account for the bulk of commodities demand, changes in volumes and composition of their demand are incremental and marginal compared to the dynamism of Southern demand. Four factors explain the very rapid growth of developing country commodity demand. First, the faster growth in developing countries means that they account for an increasing share of world demand. Secondly, developing countries are generally at a stage in their economic development where per capita consumption of commodities, both industrial raw materials and food, increases fast. It is generally recognized that the "materials intensity" of an economy increases fastest in the early stages of industrialization before reaching a saturation point, beyond which materials use per unit of GDP does not grow, and that total food consumption in terms of daily calorie intake does not increase much once basic needs are satisfied.[8] Thirdly, two of the fastest growing developing economies, China and India, are also the world's most populous countries and among the world's largest economies. Fourthly, the structural change in developing country economies has led to greater complementarities between them, opening up opportunities for increased commodities trade.

12. The increase in South-South commodity trade has been very fast since 2000, and in this period it has also assumed proportions that make it a dominant influence on international commodity markets. International trade in commodities overall increased fast in value terms during the period 2000-2004 (about half the increase was owed to the improvement in prices) — by 46 per cent for agricultural commodities and by 57 per cent for minerals and metals. However, South-South commodities trade increased even faster, with the share of developing countries' commodity exports that go to other developing countries increasing from 39 per cent in 2000 to 44 per cent in 2004, while the share of imports from other developing countries went up from 45 per cent to 50 per cent.[9] The importance of South-South trade differs markedly among the main regions, with its share of total commodities trade being lowest in the Latin American and Caribbean region, slightly higher in Africa and much higher in Asia (see table 1). Asia accounts for slightly less than half of the exports in South-South commodity trade and for a little more than 60 per cent of imports. Trade among developing countries within the same region is also particularly important in Asia, with intra-Asian trade accounting for about 45 per cent of both commodity imports and exports. However, in all regions other developing countries have become more important both as markets for commodity exports and as suppliers of imports. Moreover, although the increase in the share of South-South trade has been more spectacular for minerals and metals than for other commodities, with the share of South-South imports reaching 55 per

[7] UNCTAD/TDR/2005.

[8] See UNCTAD/TDR/2005, p. 44-51, for a detailed discussion of the reasons for the changes in the relationship between income and commodity as income increases.

[9] See UNCTAD/DITC/COM/2006/5 for a detailed analysis of South-South commodity trade flows.

cent in 2004, from 47 per cent in 2000, developing countries are also increasingly sourcing imports of agricultural commodities from the South.

Table 1
South-South commodity trade (including fuels) by regions, 2000-2004

	Share of commodity exports to developing countries, percentage of total		*Share of commodity imports from developing countries, percentage of total*	
Region	*2000*	*2004*	*2000*	*2004*
Africa	28	31	33	38
America	23	26	28	32
Asia	44	48	51	55
All developing countries	39	44	45	50

Source: Calculations by UNCTAD secretariat on the basis of Comtrade data.

13. Therefore, although Asia dominates the overall picture and its trade is more aligned along the South-South dimension than that of other regions, the increase is clear in other regions as well and is not confined to industrial raw materials, in spite of the surge in trade of these commodities having received more attention than the increase in trade in food and other agricultural commodities.

14. With respect to mineral commodities, it should first be noted that developing countries increased their share of world imports from 27.5 per cent to 35 per cent from 2000 to 2004, and their share of exports from 30 per cent to 36.5 per cent. Exports from all developing regions grew faster than total world trade in mineral commodities, and only in the Latin American and Caribbean region did imports increase slower than world imports. The most notable development was the increase in the share of exports to Asia from all regions. The value of Asian imports of metals and minerals increased by 112 per cent from 2000 to 2004.

15. For agricultural commodities, developments have been slightly less dramatic, although both Southern exports and imports increased at roughly the same rate as world trade, with imports however growing slower in the Latin American and Caribbean region and African exports increasing somewhat faster. In Africa, the shares of imports, particularly of food, from both America and Asia have increased, while the share of intraregional imports has remained constant. American exports to Asia have increased their share of total exports, while the share of intra-American exports fell. Finally, the share of imports from America increased in Asia.

B. South-South commodity trade as an engine of growth and poverty reduction

16. As was noted in a previous report of the Secretary-General to the General Assembly on the same subject,[10] increased demand for commodities in Asian developing countries could considerably boost world demand for commodities, and a window of opportunity could thus open up over the next several years, allowing

[10] A/59/304, para. 17.

substantially improved export earnings for commodity exporting developing countries. These prospects raise the twin questions of the extent to which South-South commodity trade can serve as an engine of growth in developing countries and how it can be made to benefit a broad segment of the population and thus contribute to poverty reduction. The response to these questions may depend on the types of commodities exported by a particular developing country and on the destination of its exports, as well as on the policies pursued by Governments. Important measures of success include the extent to which value added accrues to the country, revenues are channelled towards investment in social and physical infrastructure, and employment generation. Three types of South-South commodity trade are analysed below with a view to determining their potential contribution to development and identifying the ways in which the international community can help to realize that potential.

1. Increasing Asian demand for energy and industrial raw materials

17. The rapidly increasing demand for energy and industrial raw materials in Asia, particularly China and India, has benefited developing countries exporting these commodities. Virtually all metals industries are operating at close to full capacity and inventories are at a historical low. Consequently, prices are high, particularly since, as described in section II above, investors anxious to find alternatives to lacklustre markets for financial assets have invested enthusiastically in metals market derivatives. It is generally believed that, although the speculative element could disappear from metals markets at short notice, prices will remain at above long-term trend levels for several years more. This belief is based on the simple observation that even if there is a slight slowing down of demand growth in Asia, the rate of growth will still be sufficient to yield major increases in global demand, given that Asian demand is now much larger than only a few years ago. For instance, in 2005, China's demand for iron ore increased by an amount corresponding to 70 per cent of total European demand (except the Commonwealth of Independent States demand that year) and to 155 per cent of total North American demand.[11] Accordingly, conservative projections of Asian (and world) demand, when matched against what is known about expansion plans in the world mining and metals industry, point to there being very little excess capacity in the medium term.[12] Since the major share of mining and metals investment is expected to take place in developing countries,[13] a number of these countries are likely to see revenues from mineral commodities exports increase.

18. The challenge for the countries benefiting from rapidly growing demand for minerals and energy will be to convert the revenues into development gains. There is a rich literature on the contribution of the natural resources sectors to economic growth and development, with much of it focusing on the risks of basing development strategies on these sectors and with some of it arguing that countries

[11] UNCTAD/DITC/COM/2006/7.

[12] For an example of such a projection, see UNCTAD/TDR/2006 (forthcoming).

[13] Although it is difficult to obtain reliable or comprehensive data on planned investment, an indication of trends is provided by the annual survey on exploration expenditure carried out by the Metals Economics Group which is estimated to cover 95 per cent of global exploration expenditure (see www.metaleconomics.com). According to this survey, exploration spending increased in 2005 (by 34 per cent) for the third consecutive year and it has grown particularly fast in Africa.

dependent on natural resource exploitation are subject to a "resource curse". While space does not allow a review of the arguments of the general debate,[14] it is relevant to review to what extent an increase in South-South trade and foreign direct investment (FDI) in these sectors would affect the capacity of natural resource dependent countries to manage the risks.

19. There is no particular reason to expect that South-South trade in mineral and energy commodities will differ significantly in nature from that of trade in general for these commodities or change established trading practices. While the dominance of Asian importers may lead to some changes in trading practices, these changes are difficult to anticipate and do not appear to follow any particular pattern. It should also be noted that both energy and metals markets have a long history of globalization and are both transparent and highly interconnected.

20. A significant portion of the expected investment in natural resource exploitation will be carried out by Asian companies, particularly Chinese, driven by concerns about security of supply and competition with established developed country companies. While it is difficult to trace FDI by these companies in the statistics,[15] anecdotal evidence suggests that they account for a significant and rising proportion of total investment in the natural resources sector. The emergence of these companies as important investors raises two issues. First, international investment by Asian companies has often taken place in a context of bilateral Government level arrangements and there is a high degree of Government involvement in projects. There may be possible advantages to this involvement of Governments in natural resource exploitation investment projects. In addition to concessionary financing terms, these may include possibilities of integrating projects better into a national development strategy, for instance, by making possible a coordinated implementation of investment in infrastructure and in natural resource projects. Realizing these advantages depends largely on the strength and capabilities of host country institutions.

21. Second, over the past several years the international mining industry, having been the subject of very strong criticism for its approach to issues such as environmental management, relations with local communities and the rights of indigenous peoples, has made efforts to improve its practices, including by drawing up codes of conduct and promoting "good practices". Asian companies, having emerged on the international scene more recently and not having been exposed to the same criticisms, have by and large been absent from the deliberations preceding these improvements and have made few binding public commitments to "good practices". Their adjustment to emerging industry norms will hopefully take place without friction, but it may pose challenges for the enforcement mechanisms of host countries. Meeting these challenges may be made more complicated by the already-mentioned involvement of Governments, which means that decisions on environmental management and local development could at least theoretically be

[14] For a recent review of how some countries have managed the challenges, see "The challenge of mineral wealth: using resource endowments to foster sustainable development, synthesis of four case studies", International Council on Mining and Metals, UNCTAD and the World Bank, April 2006 (www.icmm.com/publications/11175Synthesis.pdf).

[15] The UNCTAD World Investment Report 2006 (forthcoming) contains a detailed discussion of the difficulties in identifying this type of FDI statistically, but concludes that it constitutes an important portion of FDI originating in developing countries, which in its turn is growing more rapidly than total FDI.

influenced by foreign policy considerations. Practicing responsible management of natural resources is usually easier if the roles and distribution of responsibilities of Governments and the private sector are clear. This underlines the need for an active debate about governance in the natural resource sector, particularly with respect to the need for transparency on financial conditions,[16] and for technical assistance in the areas of design and implementation of regulations to Governments in host countries.

2. Shifts in the composition of food demand

22. Increasing incomes and living standards in China and India, and also in other developing countries, will lead to changes in the composition of international demand for food. The main effect of increased income at lower levels of income per capita is increased total food consumption, measured as calorie intake. At higher levels of income, however, the composition of diets change as new food products come within economic reach of households, with a higher proportion consisting of fruits and vegetables, meat, dairy products, fish and seafood.[17] Consumption of "luxury" foods such as coffee and cocoa usually also increases with rising incomes.

23. It is probable that both China and India will be able to cover a large portion of their increased food demand through domestic production. Indeed, despite rapidly increasing consumption, food self-sufficiency ratios in both countries did not fall and in some cases they even rose during the period 1994-1996 to 2002.[18] There was, however, one telling exception: imports of soybeans, which are used as animal feed, increased strongly relative to domestic production in both countries. Thus, it could be said that China and India were able to maintain a high degree of self-sufficiency for meat by importing more animal feed. Moreover, while self-sufficiency ratios remained high for broad groups of food products, this reflects an increasingly complex situation with both exports and imports increasing, but for different products. As incomes rise, the range of foodstuffs consumed gets broader and international trade increases accordingly. Table 2 shows the evolution of Chinese imports of some of the products whose demand would be expected to increase with rising incomes. While the absolute quantities may still be small, the growth rates are impressive, with average annual growth rates ranging from 19 per cent for fish to 31 per cent for coffee, and they show no sign of falling.

24. The potential for increasing exports from other developing countries is thus impressive. The extent to which it can be realized depends on several factors. First, the suspension of the Doha round of World Trade Organization negotiations announced on 24 July 2006 means that there are less grounds for optimism about a reduction of domestic agricultural subsidies in developed countries, and that subsidized surplus production from these countries may meet a significant portion of Asian demand. Second, both China and India have relatively high tariffs on agricultural products, and this may place a brake on the rate of increase in imports. Third, the existence of steep Asian tariffs also points to a possible way forward in

[16] The Extractive Industries Transparency Initiative, which was announced by Prime Minister Tony Blair of the United Kingdom at the World Summit on Sustainable Development in Johannesburg, September 2002, has contributed to improving the openness about financial conditions surrounding investments in energy and mining industries (see www.dfid.gov.uk/News/files/extractiveindustries.asp).

[17] See UNCTAD/TDR/2005, p. 44-46, for a discussion of the illustrative and differing Chinese and Indian experiences in this respect.

[18] UNCTAD/TDR/2005, table 2.3.

the form of mutual preferential arrangements between developing countries; for instance, within the context of the Generalized System of Trade Preferences. Fourth, while non-tariff measures for food products, particularly with respect to sanitary and phytosanitary standards, that generate costs to exporters are applied in Asian countries and in other developing countries, they are generally less complex and easier to comply with than those of developed countries, and market requirements, including private sector quality standards, are somewhat less stringent. This means that developing country producers can realistically consider a strategy of export market penetration "step by step", targeting first domestic markets, then regional ones and those of other developing countries before attempting to break into developed country markets.

Table 2

Chinese imports of selected food products, 2000-2005, US$ million

Year	*Fish*	*Vegetables and fruit*	*Coffee*	*Cocoa*
2000	1 217.1	516.0	7.1	36.1
2001	1 337.4	674.8	8.4	37.3
2002	1 574.4	688.8	10.1	32.3
2003	1 884.0	870.9	17.3	58.6
2004	2 362.9	1 168.7	20.2	71.6
2005	2 903.7	1 348.8	27.4	112.2

Source: Calculations by UNCTAD secretariat on the basis of Comtrade data.

3. Regional trade in food staples

25. The potential for increasing South-South trade in agricultural products has been given increasing attention lately. In countries at low levels of income, consumption of basic foods such as sugar, tubers, vegetable oils and cereals is low. As incomes rise, consumption will increase, creating considerable scope for both domestic production and trade. However, the trade potential is often seen as being concentrated in products that are already internationally traded, as described in the preceding section, while the prospects for increasing trade in local and indigenous food staples are often overlooked, mainly because international trade in most of these products is modest in terms of value. Nevertheless, it can be argued that increasing food staples trade holds several advantages for developing countries, particularly the poorest and those with relatively undeveloped commercial infrastructure, as is the case of many African countries. Such markets offer fewer barriers to entry for small farmers, and therefore offer the prospect of raising rural incomes and reducing poverty. Moreover, increased availability of staple foods can lead to dramatic improvements in food security. It is noteworthy that production of some staple foods in sub-Saharan Africa has shown impressive increases in recent years. Table 3 shows the evolution of production and exports of some such products. It is somewhat surprising that exports constitute only a small portion of production (intra-sub-Saharan Africa exports are included). One explanation is that a portion of the trade that goes on is informal and not registered in statistics. However, there are other reasons for the slow development of trade, including:

- High transport costs;

- Lack of domestic economic integration, reflected in unorganized, underdeveloped and incomplete domestic markets, inadequate institutions and disruptions in price transmission between different market levels and regions;
- An unfavourable environment for local entrepreneurs to emerge in commodity marketing, processing and trade;
- Vulnerability to risk, both at the macroeconomic, national level and locally among large parts of the population, especially in rural areas.

Table 3
Sub-Saharan production and exports of staple foods products, thousand tons

		1990	2000	2003
Cassava (in all forms, cassava equivalent)	Production	70 044	96 745	101 650
	Exports	113	15	39
Millet	Production	10 566	12 646	14 802
	Exports	21	27	6
Sorghum	Production	10 989	17 119	22 332
	Exports	111	63	49

Source: FAOSTAT Database.

26. It has been argued that,

> "... the greatest market potential for most African farmers still lies in domestic and regional markets for food staples (cereals, roots and tubers and traditional livestock products). For Africa as a whole, the consumption of these foods accounts for about 70 per cent of agricultural output ... and is projected to double by 2020 ... Moreover, with increasing commercialization and urbanization, much of this additional demand will translate into market transactions and not just additional on-farm consumption. There are no other agricultural markets that offer growth potential on this scale and that could benefit huge numbers of Africa's small farmers".[19]

27. Better integration of regional markets could provide important outlets for increased grain production in some countries. A basis is already there in some products, particularly in certain regions. Staple cereals, including maize, comprised the largest element of intra-sub-Saharan African trade, amounting to $310 million annually or exactly one sixth of total intra-sub-Saharan African trade, in the 1996-2000 period.[20] More than 50 per cent of sub-Saharan African maize imports came from other sub-Saharan African countries, mostly within the same subregion as the importing country; 60 per cent of East Africa's maize imports were intraregional.[21] What this may indicate is a complementarity in food production and consumption in

[19] Hazell, P., "The role of agriculture and small farms in economic development", prepared for the workshop on the theme "The future of small farms", June 2005.

[20] X. Diao, P. Dorosh and S. M. Rahman, "Market opportunities for African agriculture: an examination of demand-side constraints on agricultural growth", DSGD Discussion Paper No. 1, table 5, p. 12, International Food Policy Research Institute (Washington, D.C., 2003).

[21] PricewaterhouseCoopers, "Sustainability Impact Assessment (SIA) of the EU-ACP Economic Partnership Agreements: Phase Two" (Paris, 2005).

many cases between countries within regions in Africa. Given the severe communications difficulties and other transaction costs between African countries, it could be more feasible to build on such trade within a subregion of the continent than to expand it between subregions at this stage. Intra-African trade is already quite highly developed in certain products, but there are formidable obstacles along the path. Important issues that need to be addressed at national, regional and international levels include:

- The extent to which intraregional trade is inhibited by the lack of appropriate commercial and administrative institutions;
- Barriers to trade both within countries and between neighbouring countries in sub-Saharan Africa;
- The proliferation of existing regional economic groupings, with different and overlapping memberships operating according to different economic principles;
- The lack of standardized packing, grading and quality-control systems at regional levels.

28. African Governments are highly aware of the need for actions in these areas, and the African Union has adopted the Arusha Plan of Action on African Commodities, which addresses all of the concerns raised above. The Plan of Action also points to the need for international support measures, including through the allocation of a larger proportion of currently increasing trade-related official development assistance (ODA) to the commodity sector through commodity-related organizations.

IV. Review of the implementation of General Assembly resolution 59/224

29. General Assembly resolution 59/224 on commodities contains a wide variety of addressees, ranging from developing and developed countries and their Governments to international organizations and the private sector. Activities have been undertaken in most areas referred to, sometimes going beyond the specific requests in the resolution. For example, in paragraph 10 the Assembly only "Reiterates the importance of expanded South-South trade" and in paragraph 11 "Recalls the potential of regional integration", without calling upon any actor for any specific action. These are areas, however, where UNCTAD has been particularly active since the fifty-ninth session of the General Assembly.

30. In paragraph 6 of the resolution, Developing countries have been encouraged, "with the necessary support of donor countries and the international community, to formulate specific commodity policies", and in paragraph 8 they have been invited "to prioritize agriculture and rural development in their national development strategies and programmes". One important manifestation of that has been the adoption by the African Union, at its sixth Summit, of the Arusha Declaration on African Commodities and the Plan of Action on African Commodities, which was conceived in the context of the New Partnership for Africa's Development and the overarching targets of the Millennium Development Goals. Support in this process was provided by the Common Fund for Commodities and UNCTAD. As an

important step in the implementation of the Arusha Declaration and the Plan of Action on African Commodities, the Common Fund for Commodities initiated a meeting of the African regional economic communities in collaboration with UNCTAD and the African Union, to discuss regional commodity development issues and identify specific development programmes of regional economic communities for support of the Fund.

31. Regarding schemes to mitigate earnings shortfalls,[22] although under the current rather favourable price situation this may appear less urgent, it remains extremely relevant from a longer term point of view. Moreover, shortfalls may arise as a result of factors other than prices, such as natural disasters or other supply side shocks. Assessment of the effectiveness of systems for compensatory financing continues without much operational progress. However, insurance against risk, including natural disasters, appears to be a new area of considerable attention.

32. A review of commodity-related activities of international organizations mentioned in General Assembly resolution 59/224 reveal that, to a large extent, these are responding to the various elements contained in the resolution. Paragraphs 15, 18 and part of 21 of the resolution can be mentioned in this connection. While research-oriented action that falls within the work programmes of the relevant institutions has proceeded as required, there are certain areas where response to the resolution depends on the availability of extrabudgetary financial resources, which, at least in the case of UNCTAD, have not been forthcoming in spite of the invitation of the Assembly in paragraph 17 of the resolution to "development partners to provide the resources required to enable" UNCTAD to undertake the requisite activities.

33. Recent initiatives show that there has been positive response to the calls for "reinforcing ... financial and technical support", contained in paragraph 8 of the resolution. For example, there are commodity-related programmes, with substantial resources under way, such as the European Union All ACP Programme for agricultural commodities in which UNCTAD is a partner along with the Common Fund for Commodities, the Food and Agriculture Organization of the United Nations (FAO), the International Trade Centre UNCTAD/WTO (ITC) and the World Bank. The various support schemes announced for cotton, in particular for West and Central African countries, are also examples. Nevertheless, there are many lacunae that need to be filled, both in terms of geographic and topical coverage, design and delivery mechanisms. In the recent initiatives, policy aspects, as well as direct links with poverty reduction, seem to have been underemphasized. Also, the underprivileged segments of the rural societies, including in mineral-dependent countries, seem to be receiving little attention. Innovative financing schemes for the commodity sector, which can provide cost effective solutions to commodity sector development is another area that would merit attention.

34. The private sector has also been addressed in paragraph 14 of the resolution, being invited "to promote partnerships that contribute to the effective participation of small producers in supply chains". There is considerable interest in the private sector to build such partnerships, both individually in terms of technical support provided to their suppliers and on an industry-wide basis through instruments such as codes of conduct and the promotion of best practices. Some technical cooperation

[22] See General Assembly resolution 59/224, para. 16.

activities by UNCTAD, undertaken together with the private sector, have had significant positive results that can be considered the implementation of this part of the resolution. There is considerable scope for expanding such activities, which would benefit from support by Governments.

35. Also stressed in paragraph 9 of the resolution was the "importance of a successful conclusion of the Doha work programme" and improved market access for the least developed countries was called for in paragraph 12. In spite of the considerable energy spent and effort made, for example, at the ministerial meeting of the World Trade Organization, held in Hong Kong, it has not been possible to reach an agreement within the agreed deadlines. The suspension on 24 July 2006 of the negotiations at the World Trade Organization under the Doha work programme has serious implications for the international trade and development agenda. One of the implications is that the distortions in agricultural markets will continue, affecting seriously and in a negative way much of the commodity-based development and diversification efforts of many developing countries. A second implication is that with the pause in this important phase of multilateralism and the doubts that have been raised about progress, regional and bilateral trade arrangements will become more predominant. It is often observed that agricultural trade is even more difficult to liberalize in regional and bilateral arrangements than in multilateral negotiations. This is likely to bode ill for increased agricultural exports by developing countries. Another consequence of this pause in the Doha round negotiations, however, is to bring a sense of urgency to increasing South-South trade and to the negotiation of South-South trade arrangements that will increase trade among developing countries, particularly in a way that does not disfavour agriculture. An issue of importance in the Doha process, particularly for countries in West and Central Africa, is the future direction of the sectoral initiative in favour of cotton, which was originally introduced by Benin, Burkina Faso, Chad and Mali, and which led to the creation of a subcommittee on cotton so as to address cotton-specific trade and development issues ambitiously, expeditiously and specifically. As it had been linked to progress in agricultural negotiations, ways need to be found to move forward in the light of the suspension of negotiations. Although cotton prices have improved recently, the need to reduce distortions in the cotton market and to attend to the concerns of the African cotton-producing countries continue.

36. As called for in paragraph 19 of the resolution, the UNCTAD secretariat has continued to work for the effective operation of the International Task Force on Commodities launched at UNCTAD XI. Former President of the United Republic of Tanzania Benjamin William Mkapa has agreed to chair the Task Force. The financial resources to fully operationalize the consultative mechanism, however, have not been forthcoming. Nevertheless, action along the lines envisaged by UNCTAD XI is taking place in the form of partnerships and action groups, for example, in the areas of mining, sustainability initiatives in the commodity sector, and enabling small producers to enter world markets. The multitude of addressees of General Assembly resolution 59/224, comprising private, public, national and international entities, is a clear demonstration of the need for such an independent and multistakeholder task force. It would facilitate synergies, promote communication and generate novel approaches to dealing with commodity problems without any bureaucratic or hierarchical considerations in a cooperative manner.

37. The Assembly, in paragraph 20 of the resolution, "underlines the need to strengthen the Common Fund for Commodities" and enumerates a number of areas where it should continue to strengthen its activities. The Common Fund for Commodities has continued to support developing countries in the areas mentioned in the resolution, but it has also taken measures to enhance the efficiency and effectiveness of its operations. Particular emphasis is being placed on the need to make projects more focused on a narrow range of objectives addressing supply chain improvement, value addition, market access and market development issues. In spite of the call to strengthen the Common Fund for Commodities, its resource constraint would particularly be acute in the forthcoming five-year action plan for the period 2008 to 2012, given the programme approach being introduced by the Fund and a more forward-looking commitment required from voluntary contributions to the Second Account resources. The international organizations mentioned in the resolution have been, to a varying extent, beneficiaries of resources of the Common Fund for Commodities. In this connection, the main area of relevance for the World Bank is price risk management. While UNCTAD is involved with projects on commodity policies and information comprising agricultural products, as well as development strategies in regions dependent on metals and minerals, ITC engagement with projects of the Common Fund for Commodities focus on generic promotion, value addition and export strategies. Being the home of 11 International Commodity Bodies, FAO is in a different situation, and a variety of projects are implemented through its Intergovernmental Groups on specific commodities. Since the adoption of resolution 59/224, the International Commodity Bodies at FAO have supervised 27 projects that have a supply chain concept as described in paragraph 20 of the resolution. An ongoing project of the International Coffee Organization, with substantial financing from the Common Fund for Commodities, has also been implemented by FAO.

V. Conclusions

38. Commodity prices have improved considerably over the past few years. It is not likely that the price increases constitute a break with the declining long-term trend in real prices, but they provide an opportunity for developing countries to address urgent development challenges and embark on programmes targeting specifically small and poor commodity producers. The challenge is to distribute the benefits to disadvantaged segments of society, to reduce poverty and to settle on a sustainable growth path. Such programmes should aim at facilitating diversification and structural change in commodity-dependent economies and enabling producers to adjust better to inevitable future price falls. In addition, support from the international community is necessary, including in the form of improved and more user friendly schemes for mitigating export earnings shortfalls. Insurance-based solutions that facilitate the funding of such schemes and permit more timely support to exporters, should be pursued as a matter of priority.

39. The suspension of the Doha round negotiations means that hoped for improvements in the functioning of world markets for agricultural products and supportive measures for developing countries, including through the aid for trade mechanism, are unlikely to materialize in the short term. Accordingly, the development of the commodity sectors will rely fundamentally on commodity-specific policies at the international, regional and national levels. Such policies

should target least developed country producers and producers in other developing countries that have been left out of the development process. Technical assistance and capacity-building aimed at improving the competitiveness of commodity producers is particularly important in this context.

40. In the past few years, trade among developing countries has provided almost all the dynamic stimulus to commodity markets. Growing Asian demand for commodities is partly behind this expansion of South-South trade, as well as the sustained rise in commodity prices. It is important that this new dynamism be put to good use in supporting development and poverty reduction, particularly in the poorest and most commodity-dependent developing countries. In this respect, it is particularly important to realize the potential for increased trade in staple foods, particularly among countries in the same subregion.

41. Developing countries will need to assess how South-South commodity trade can make an even greater contribution to broad and inclusive growth and development. This is likely to entail serious efforts to remove obstacles to trade, focusing on those geographical and product areas where substantial increases in trade volumes can most easily be attained, as well as the design of policies aimed at deepening the impact of trade and facilitating a wider distribution of its benefits.

42. The aid for trade mechanism should be pursued independently of developments in the Doha round and not be considered solely as a means to help countries adjust to trade liberalization. It should support the improvement of trading capacity and, taking into account the needs of the least developed countries and other vulnerable economies, should have a strong commodity focus. It should be adequately funded and brought into operation urgently.

43. With respect to the implementation of General Assembly resolution 59/224, the intergovernmental organizations identified in the resolution have all continued to give priority to commodity issues in their work programmes. However, few new resources have been made available. In the present situation, with developing countries having to rely on South-South trade as the main or only dynamic element in commodity markets, technical assistance to support policy development and capacity-building assumes increased importance, particularly in order to enable developing countries to adjust to the requirements of this dynamic segment of international trade.

44. The International Task Force on Commodities launched at UNCTAD XI has, regrettably, not entered into force, owing to the absence of financial support from Member States. The multitude of addressees of resolution 59/224, comprising private, public, national and international entities, is a clear demonstration of the need for appropriate mechanisms that allow consultation among stakeholders and focus the attention of Governments, civil society and the enterprise sector.